Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Ortiz	Analyst:	Darrine Distefano	Bill Number:	SB 75XX
Related Bills:	See Prior Analysis	Telephone:	845-6458	Amended Date:	08-27-2001
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Energy Efficient Products or Equipment Loan Interest Deduction

____	DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ________________________.
X	AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
X	AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended August 21, 2001.
X	FURTHER AMENDMENTS NECESSARY.
____	DEPARTMENT POSITION CHANGED TO ________________________.
X	REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED August 21, 2001 STILL APPLIES.
____	OTHER - See comments below.

SUMMARY

This bill would allow a deduction for interest paid on any loan or financed indebtedness from a utility company to purchase energy efficient equipment and products for California residences.

SUMMARY OF AMENDMENT

The August 27, 2001, amendments will do the following:

* Allow the interest paid on any loan or financed indebtedness as an itemized deduction in computing taxable income rather than as an adjustment to gross income.
* Allow the publicly owned utility company to notify the taxpayer of their eligibility for the deduction using a federal income tax form.
* Make other technical changes.

The amendments do not resolve the department's technical consideration with respect to the bill as amended August 21, 2001, and create a new concern. Accordingly, the unresolved technical considerations are provided below for convenience. Also, since the amendments change how the deduction is claimed, a new revenue estimate is provided below. The remainder of the department's analysis of the bill as amended August 21, 2001, still applies.

Board Position:			Legislative Director	Date
X S	NA	NP	Brian Putler	09/13/01
SA	O	NAR		
N	OUA	PENDING		

POSITION

Support.

At its June 27, 2001 meeting, the Franchise Tax Board voted 2-0 to support this bill, with Annette Porini, on behalf of Member B. Timothy Gage, abstaining.

TECHNICAL CONSIDERATIONS

The language changes the deduction from an adjustment to gross income to a miscellaneous itemized deduction subject to the 2% floor of adjusted gross income (AGI). (Only miscellaneous itemized deductions in excess of 2% of the taxpayer's AGI are deductible.) It seems the author's intent is to allow the entire amount of interest to be deductible, similar to the current qualified residence interest deduction. In order to effectuate this intent, the language needs to be amended to eliminate the 2% floor of AGI limitation for this deduction.

The requirement for a public utility to issue a federal income tax Form 1098 would be inappropriate. State law cannot prescribe the use of a federal form. A federal Form 1098 is used to report $600 or more of mortgage interest received during the year. The author may wish to amend the bill to delete the requirement to issue a Form 1098 and retain provisions to have the public utility issue a form similar to the Form 1098. In addition, this reporting requirement would be more appropriately located in the Administration of Franchise and Income Tax (AFTIL) with other reporting requirements. Department staff is available to work with the author's office to assist with drafting language for this requirement.

The language in the bill encouraging public utilities to notify their customers about the interest deduction provided by the bill or provided on a home equity or home improvement loan may be more appropriately located in the Public Utilities Code.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this bill would result in insignificant revenue losses of less than $100,000 annually beginning in 2001-02.

Revenue Discussion

The revenue impact of this bill would be determined by the amount of deductible interest on loans from public owned utilities for energy efficient products or equipment not otherwise deducted as home equity financing and the marginal tax rate of taxpayers incurring such interest.

The August 27 amendment changed the proposed deduction from computing AGI to computing taxable income. Projected revenue losses are decreased from that of the prior version of the bill of $0.8 in 2001-02, $1.0 in 2002-03, and $1.5 million in 2003-04, to losses of less than $100,000 annually. As a miscellaneous itemized deduction, interest on loans from public owned utilities for energy efficient products or equipment would be included with other miscellaneous itemized deductions, if any, and would be deductible only to the extent they exceed 2% of AGI.

Only one significant municipal utility district in California was identified as lending money to its customers to encourage and enable them to acquire and install energy efficient products or equipment at a qualified residence. According to staff at this municipal utility district, outstanding loans currently total roughly $70 million. Each year, some level of new loans is funded and a certain level of existing loans is paid off. Once funded, borrowers generally repay loans, on average, over a period of 48 months. This utility district currently offers fixed interest rates that vary according to the amount of the loan. The overall average interest rate is estimated at 9%. By using personal income tax sample data and a series of assumptions as a proxy, deductible interest would range from between $500,000 and $1 million. Assuming an average marginal tax rate of 6% for taxpayers who borrow, revenue losses under current conditions would range from between $30,000 and $60,000. If, however, due to the enactment of the proposed deduction, other utilities initiated similar loan programs, revenue losses potentially would increase in subsequent years.

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